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No. 83-1007

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

TIFFANY FINE ARTS, INC., *et al*
Petitioners

v.

UNITED STATES OF AMERICA, *et al*
Respondents

On Writ Of Certiorari To The United States Court of Appeals For The Second Circuit

BRIEF FOR PETITIONERS'

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QUESTIONS PRESENTED

(1) Whether an Internal Revenue Service general summons, issued under 26 U.S.C. §§ 7602 and 7604, which is served on a record keeper before an audit of the record keeper begins in substance and which seeks the identities of unnamed taxpayers, must comply with the provisions of 26 U.S.C. § 7609(f) regarding John Doe summonses, particularly when the Service has enunciated an institutional purpose to audit such unnamed taxpayers.

(2) Whether a record keeper served with such a summons is entitled to an evidentiary hearing to determine if a John Doe summons subject to the provisions of 26 U.S.C. § 7609(f) is masquerading as a general summons.

PARTIES

The parties in this case are Petitioners Tiffany Fine Arts, Inc., and its wholly-owned subsidiaries, World Video Corp. and World Medical Marketing Corp. and Respondents-Appellees the Internal Revenue Service by a Revenue Agent, Joel Lewis, and the United States of America.

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BRIEF FOR PETITIONERS'

REPORTS OF OPINIONS

The opinion of the Second Circuit Court of Appeals in this case is reported at 718 F.2d 7 and is set forth in appellants' Petition for a Writ of Certiorari ("Petition"), Appendix A.

The order of the United States District Court for the Southern District of New York was not accompanied by an opinion. The order is set forth in the Joint Appendix, at 39a-40a.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The statutory basis for jurisdiction in the United States District Court is 28 U.S.C. § 1331.

The decision sought to be reviewed herein was entered by the United States Court of Appeals for the Second Circuit on September 13, 1983. An order denying a rehearing was entered by the Court of Appeals on October 28,1983. That order is set forth in Appendix B of the Petition. An order granting a stay of the mandate of the Court of Appeals to permit appellants to petition this Court for a writ of certiorari was entered on November 21, 1983. That order is set forth in Appendix C of the Petition. The Petition was filed with this Court on December 19, 1983.

STATUTES INVOLVED

The following statutes are involved in this case:

26 U.S.C. (Internal Revenue Code of 1954, as amended) § 7602(a):

> AUTHORITY TO SUMMON, ETC. For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place

> named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

26 U.S.C. § 7604(a).

> JURISDICTION OF DISTRICT COURT—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

26 U.S.C. § 7609(c):

> (1) IN GENERAL—Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602 or under section 6420(e)(2), 6421(f)(2), or 6427(b)(2) and requires the production of records.
>
> (2) EXCEPTIONS—A summons shall not be treated as described in this subsection if—
>
> (A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection(a)(3)(A), or
>
> (B) it is in aid of the collection of—
>
> (i) the liability of any person against whom an assessment has been made or judgment rendered, or
>
> (ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).

(3) RECORDS, CERTAIN RELATED TESTIMONY—For Purposes of This Section—

(A) the term "records" includes books, papers, or other data, and

(B) a summons requiring the giving of testimony relating to records shall be treated as a summons requiring the production of such records.

26 U.S.C. § 7609(f):

ADDITIONAL REQUIREMENT IN THE CASE OF A JOHN DOE SUMMONS—Any summons described in subsection (c) which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that—

(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,

(2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and

(3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

26 U.S.C. § 7609(h)(2):

SPECIAL RULE FOR PROCEEDINGS UNDER SUBSECTIONS (f) AND (g).—The determination required to be made under subsections (f) and (g) shall be made ex parte and shall be made solely on the petition and supporting affidavits.

STATEMENT OF THE CASE

Petitioners (hereinafter, "Tiffany") sell products to investors under arrangements which the Internal Revenue Service ("IRS" or "Service") views as "tax shelters." During 1979 and 1980 Tiffany sold to various persons approximately 50 to 100 licenses for one of Tiffany's products—a medical device called a "Pedi-Pulsor." Under the structure of the licensing program, licensees received tax benefits for the years 1979 and 1980.

From the start, the Service's interest in Tiffany has been to determine the identities of its licensees on the theory that they were tax shelter investors. Sometime in the summer of 1981, Revenue Agent Joel Lewis ("Agent Lewis") visited the premises of Tiffany and requested the names, addresses and social security numbers of all Pedi-Pulsor licensees. Joint Appendix ("JA") 17a. Agent Lewis did not request the standard financial information which is necessary to conduct any legitimate audit of a taxpayer. *Id.* He sought only the identities of Tiffany's clients. Agent Lewis was referred to Tiffany's attorney who rejected his request for this information. *Id.*

No further contact with Agent Lewis occurred until October 6, 1981, when Tiffany was served with four IRS administrative summonses. These summonses are set forth in full in the Joint Appendix. JA 4a-7a. Two of them were issued to Tiffany Fine Arts, Inc. JA 4a and 5a. These two summonses seek identical information. The first paragraph of each summons requests the books and records of Tiffany and its subsidiaries. The next three paragraphs request the names, addresses and taxpayer identification numbers of persons who acquired Pedi-Pulsor distributorships (paragraph 2), of persons who acquired lithographs (paragraph 3), and of persons who acquired any asset (paragraph 4) from Tiffany Fine Arts,

Inc., or its subsidiaries. Tiffany has never sold lithographs. JA 18a.

The remaining two summonses were issued to a Tiffany subsidiary, World Medical Marketing Corp. JA 6a and 7a. These two summonses also seek identical information. The first paragraph of each summons requests the books and records of the company, and the second paragraph requests the names, addresses and taxpayer identification numbers of persons who acquired Pedi-Pulsor distributorships.

All four summonses were issued under Title 26, U.S.C. (Internal Revenue Code of 1954, as amended (hereinafter, "Code")) § 7602.

Tiffany offered to comply fully with the summonses—except for the disclosure of its clients' identities. It offered to produce for the IRS all of its books and records with the names of its clients redacted. JA 17a-18a. It also offered to permit the IRS to make random verification of clients' identities to assure that Tiffany's books were accurate. JA 17a. Tiffany took the position that, if the IRS were truly interested only in auditing Tiffany, the production of its records in this manner would be more than adequate. JA 18a.[1] The IRS was not interested in narrowing the scope of the summonses. JA 24a. Agent Lewis wanted Tiffany's client list, and he wanted it immediately.

Tiffany was thus faced with the following facts: The Service had requested its client list before even starting

[1] The Service was free to request Tiffany's client list at a later time—after it had examined Tiffany's other books and records—if it still felt that obtaining the client list was essential to its audit of Tiffany.

an audit. It was not interested in limiting even temporarily the scope of the summonses or postponing the production of the client list. And it believed that Tiffany was in the business of selling lithographs—a notorious tax shelter product by Agent Lewis' own admission. JA 22. Tiffany therefore reasoned that the IRS's true motive was to audit Tiffany's clients, not Tiffany, and that the IRS was interested primarily (possibly exclusively) in determining the tax liabilities of those clients. JA 18a. Tiffany concluded that each summons served by the IRS was in substance a "John Doe" summons described in Code § 7609(f)—a summons which did not identify the person with respect to whose tax liability it was issued. The IRS had not sought District Court approval prior to serving the summonses, as required by Code § 7609(f). In Tiffany's view, the Service had attempted to circumvent Code § 7609(f) by placing it under audit and serving the summonses under Code § 7602. Accordingly, Tiffany refused to comply with the summonses.

Although neither of the internal IRS procedures for issuing John Doe (Code § 7609(f)) or general investigatory (Code § 7602) summonses are burdensome, the summonses serve different goals and the procedures reflect the different goals.

The issuance by the Service of a general summons under Code § 7602 is a simple procedure. The Revenue Agent fills out a Treasury Department Form 2039, describing what information he wants and when and where he wants it. See JA 4a-7a. The Service's authority under general summonses has been afforded wide latitude, and in most cases the agent need not even seek approval from his supervisor. See Internal Revenue Manual, Audit ("IRM") § 4022.11(2) in *Commerce Clearing House*, Internal Revenue Manual, Audit, (hereinaf-

ter, "*CCH*"), at 7013-1. No approval was needed or sought in this case.

In contrast, because of the restricted use of the summons, the issuance of a John Doe summons under Code § 7609(f) requires more effort. A Revenue Agent does not have the authority to issue a John Doe summons. Advance approval must be obtained from the Agent's case manager or group manager. IRM § 4022.12(1) (*CCH* at 7013-1 - 7013-2). The Agent must demonstrate, among other things, that there is a "reasonable basis" for believing that a person or a class of persons is improperly avoiding tax. Code § 7609(f)(2); IRM § 4022.13(2) (*CCH* at 7013-2). The summons must also be approved by the Regional Counsel's office. IRM § 4022.13(4) (*CCH*, at 7013-2). If Regional Counsel disapproves the summons, the District Director forwards the case to the Regional Commissioner. IRM § 4022.13(7) (*CCH* at 7013-2). Once the Service has decided to issue the summons, the Agent asks the United States Attorney's office to prepare an *ex parte* petition to a District Court requesting the court to authorize the issuance of the summons. See Code § 7609(h)(2). The petition includes an affidavit by the Revenue Agent, providing facts which support the "reasonable basis" test of Code § 7609(f)(2). *Id.* Upon approval by the District Court, the summons may be served.

It would not be surprising if IRS agents tried to avoid this procedure for issuing John Doe summonses by putting the record keeper under audit and obtaining the customer lists under the simpler procedures of Code § 7602. Tiffany concluded that Agent Lewis had attempted to do just that, and it respectfully declined to comply.

In response to Tiffany's position, the Service, under Code § 7604, petitioned the U.S. District Court for the

Southern District of New York for an order compelling Tiffany to comply with the summonses. At a show cause hearing, Tiffany argued that the true objective of the IRS, as evidenced by Agent Lewis' conduct and the Internal Revenue Manual, was to obtain its client list, not to audit Tiffany, and that the summonses were in substance "John Doe" summonses which should have been issued under the procedures of Code § 7609(f). JA 27a. Tiffany asked the District Court to limit the scope of the summonses to exclude customer lists. In the alternative, Tiffany requested that the court conduct a hearing to determine whether the IRS was, in fact, serving a John Doe summons subject to the requirements of Code § 7609(f) under the guise of a general summons. JA32a.

The District Court, from the bench, rejected Tiffany's request for hearing and ordered the summonses enforced in full. JA 36a-37a. The Court stayed its order pending appeal. On appeal, the Court of Appeals for the Second Circuit upheld the decision and order of the District Court. See Petitioners' Petition for a Writ of Certiorari ("Petition"), A-1. The Court of Appeals stayed its order pending resolution of the appeal to this Court. Petition, A-14.

SUMMARY OF ARGUMENT

The facts of this case which are not in dispute, including the institutional posture of the IRS, establish that the summonses served on Tiffany were issued to obtain a list of Tiffany's clients. The language of Code § 7609(f), and the legislative history behind its enactment, leave no doubt that Code § 7609(f) applies to the summonses, and that the summonses should not be enforced since the Service did not follow the procedures contained in Code § 7609(f). Due process considerations also mandate that

Code § 7609(f) apply in the present case. Deferential standards which are often accorded to the IRS's investigatory powers are not applicable in this case because of the nature of the investigation and because these standards in effect compromise the courts' own power in favor of the IRS. The application of Code § 7609(f) does not burden the IRS's ability to conduct an audit of Tiffany, but it does prevent the potential for abuse of the courts' process which is created when the requirements of Code § 7609(f) are improperly circumvented. Therefore, the summonses should be quashed or limited in scope to exclude Tiffany's client list. Alternatively, a hearing should be ordered to determine the true purpose of the summonses.

ARGUMENT

Introduction. Code § 7609(f) (hereinafter, "section 7609(f)") provides that its procedural requirements must be met before the IRS can serve "any summons . . . which does not identify the person with respect to whose liability the summons is issued." These summonses are typically called "John Doe summonses." The most important requirement of section 7609(f) is that a federal court approve the summons before it is served. See also Code § 7609(h).

Determining whom a summons identifies is normally easy. It is certainly easy in this case. The summonses identify Tiffany. They do not identify any of Tiffany's clients. If they were issued "with respect to" Tiffany's tax liability, then they are not John Doe summonses. If they were issued "with respect to" the tax liabilities of Tiffany's clients, then they are John Doe summonses, and section 7609(f) applies. The questions before the Court are twofold: Whether the summonses served on Tiffany

were issued with respect to Tiffany's tax liability, its clients' tax liabilities, or both. And if they were issued with respect to the tax liabilities of both Tiffany and its clients, whether the John Doe summons procedures apply. These questions relate not only to the authority of the IRS but also to the authority of the federal courts.

A. The Facts Establish That The Summonses Were Served To Obtain The Identities Of Unknown Taxpayers.

The facts contained in the parties' affidavits which are not in dispute, and the IRS's institutional posture, show that the summonses were issued principally with respect to the tax liabilities of Tiffany's clients.

1. *The Affidavits.*

In his initial affidavit in support of the petition to enforce the summonses, Agent Lewis states: "I am conducting *an investigation, one purpose of which* is to ascertain the correctness of the consolidated income tax returns filed by Tiffany. . . ." JA 14a (emphasis supplied). It is noteworthy that Agent Lewis states that he is "conducting an investigation" rather than that he is examining Tiffany's tax returns. Indeed, he admits in both his original affidavit and in his supplemental affidavit (JA 21a) that an examination of Tiffany's tax return is only "one" purpose of the investigation. Revenue Agents do not conduct a wide variety of "investigations." All they do is ascertain the correctness of tax returns. Proc. Reg. § 601.105(b)(1). If one purpose of Agent Lewis' "investigation" was to audit Tiffany, the only other purpose could have been to audit someone else, as well.

Dr. Steven Hofstein, Tiffany's President, states in his affidavit that a Revenue Agent visited his offices "to request a list of names, addresses and social security numbers of every Pedi-Pulsor licensees (sic)." JA 17a.

This statement by Dr. Hofstein was the foundation of Tiffany's effort to quash the summonses. Its accuracy was essential to Tiffany's case. Yet Agent Lewis in his supplemental affidavit does not deny the accuracy of this statement or even try to explain it.

Dr. Hofstein also alleges in his affidavit: "Based upon the Service's previous demand for the list of licensees it would appear *quite clearly* that the *primary purpose* of the IRS is not to audit Tiffany and its subsidiaries, but to obtain the names of the Pedi-Pulsor licensees." JA 17a (emphasis supplied). Agent Lewis does not challenge that statement, either.

And Dr. Hofstein states: "The unstated but obvious purpose of the Summonses is to obtain a list of respondents' clients under the guise of a general audit." JA 18a. Agent Lewis, in his supplemental affidavit, neither denies that statement nor makes an effort to clarify his exact purpose.

In the context of an enforcement proceeding in which Tiffany was arguing that section 7609(f) applied, Dr. Hofstein's allegations were most damaging, particularly since one Court of Appeals had ruled that a summons served on another record keeper under similar circumstances was subject to section 7609(f). See *United States* v. *Thompson*, *infra* at 16. But instead of refuting Dr. Hofstein's allegations, in his supplemental affidavit Agent Lewis merely states that Tiffany's attorney, Mr. Robson, told him that "the true purpose of my investigation was to obtain certain confidential information, namely, a list of Tiffany's subsidiaries's (sic) licensees and purchasers, rather than to obtain information on the correctness of Tiffany's returns." JA 22a. Agent Lewis does not even say that he objected to Mr. Robson's allegation or attempted to correct it. He merely states that he

advised Mr. Robson that he would be forced to issue a summons. *Id.*

Accepting as true those portions of the Lewis affidavits not denied by Hofstein, and those portions of the Hofstein affidavit not denied by Lewis, it is abundantly clear that the purpose of the summonses was to obtain Tiffany's customer list, not to audit Tiffany.

2. *The IRS's institutional posture confirms its purpose.*

The conclusion drawn from the affidavits regarding the IRS's purpose is confirmed by the fact that the IRS as an institution has a clearly defined policy of identifying activities which it views as tax shelters and of obtaining the client lists of the people who "promote" them. That is precisely what the IRS was doing in its "audit" of Tiffany.

The Internal Revenue Manual, § 42(17) 0 *et seq.* (*CCH*, at 7347-31 *et seq.*) contains the IRS's "Tax Shelter Program." At the time that the Service issued the summonses to Tiffany, lithographs were thought to be a major business of Tiffany. "Lithographs" were also targeted by the IRS as a tax shelter area in need of attention. IRM § 42(17)0, Exhibit 42(17)0-1 (*CCH* at 7347-43). Agent Lewis confirms that lithographs received special attention from the IRS. JA 22a. IRS District Offices were directed to meet Tax Shelter "program objectives through their examination of returns of tax shelters, as well as tax shelter promoters' and *investors' returns*." IRM § 42(17)2.3 (12-9-80 version) (emphasis supplied). The District Offices' responsibilities were, in part, to:

(1) obtain a list of investors from the promoter and notify the districts having investors, and

(2) furnish to the investor districts all information needed to prepare and support an examination report for the investors.

Id.

Today, IRM § 42(17)2.3 (2-23-84 version) (*CCH*, at 7347-32) reads somewhat differently. It says (emphasis supplied):

> (2) District office personnel will screen and evaluate all information received with respect to tax shelters and forward information concerning out-of-district promoters *or investors* directly to affected districts. . . .

Both the earlier and the present versions of the Manual show the importance to the IRS of obtaining identities of investors. And IRM § 4222.33 (*CCH*, at 7231-14 - 7231-15), which describes the "Management of Interrelated and Related Cases" in the case of "Entities Acting as Agents for Investors" states (emphasis supplied):

> (5) When a promotion of Schedule C or F type Tax Shelter is identified, *client lists are obtained*, and the criteria in IRM 42(17)4:(3)(a) for controlling the arrangement is met, the following procedure should be used: . . .

If Tiffany's "arrangement" was a tax shelter, it was a "Schedule C type Tax Shelter." In its haste to obtain Tiffany's client list in accordance with IRS directives, the Service assumed, wrongly, that Tiffany was in the lithograph business. The events that transpired thereafter made it clear that, when Agent Lewis directed his attention to Tiffany, his objective was to obtain the names, addresses and social security numbers of Tiffany's clients, so that the clients could be audited.

B. Section 7609(f) Requires The Application Of The John Doe Procedures Whenever A Purpose Of A Summons Is To Obtain The Identities Of Unknown Taxpayers.

Under the facts described above, section 7609(f) by itself resolves the principal legal issue in this case. It

states that "*any* summons" (emphasis supplied) "which does not identify the person with respect to whose tax liability the summons was issued" may be served only after obtaining District Court authorization to serve it. The summonses served on Tiffany were issued at least in part with respect to the tax liabilities of Tiffany's customers. The IRS does not deny that. It does not even deny that the principal purpose of the summonses was to obtain the client list. But Tiffany's clients were not identified in the summons. Therefore, section 7609(f) literally applies.

The statute does not support an argument that Congress did not intend the John Doe rules to apply when a summons was served on a record keeper which was itself under audit. In fact, Congress anticipated that possibility and provided specifically that the John Doe rules do apply under these circumstances. Section 7609(f) states (emphasis supplied):

> Any summons described *in subsection (c)* which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding. . . .

A number of summonses are described in "subsection (c)." One summons described in subsection (c) is a summons "issued under paragraph (2) of section 7602." Section 7602(a)(2) describes a summons issued to, among others, "the person liable for tax." Indeed, general IRS summonses which are served on taxpayers during an audit are issued under section 7602(a)(2). See Income Tax Regulation § 301.7602-1. Thus, section 7609(f) specifically contemplates that a general section 7602 summons served on a taxpayer during an audit—obviously with respect to its own tax liability—could also be a John Doe summons. It did not except such summonses from the

John Doe procedures of section 7609(f) merely because they were served on a taxpayer under audit.[2]

The Sixth Circuit Court of Appeals, in *United States* v. *Thompson*, 701 F.2d 1175 (1983), applied this common sense interpretation to the statute:

> Since this investigation arose as a part of the Barter Exchange Project, the "institutional posture" of the IRS as well as the "personal intent" of the agents was to target the members of the BSN, once identified through the summons process, as well as Thompson. (Footnote deleted.) *See generally United States* v. *LaSalle National Bank*, 437 U.S. 298, 316, 98 S.Ct. 2357, 2367, 57 L.Ed.2d 221 (1978). Agents Needham and Hissam admitted as much at the hearing, and it is repeatedly acknowledged in the IRS's brief and arguments. (Footnote deleted.) It is equally unquestioned that this intent existed at the time issuance of the subpoena was sought and was not merely formed after issuance of the subpoena or as an incidental effect of the resulting investigation. Under these circumstances, we believe that the literal language of the Code triggers the operation of the special procedures set forth in section 7609(f) and that it is immaterial that the primary purpose may have been to audit BSN. For authority we need look no further than the precise language and plan of the Code itself and, particularly, of section 7609(f).

701 F.2d at 1178-79. The Sixth Court also stated that its reading of the statute was "compelled" by the legislative history of the provision. 701 F.2d at 1180.

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[2] Congress did provide that the third party summons rules of Section 7609(a), which govern in the case of known taxpayers, do not apply if it is the record keeper's tax liability which is under investigation. See Code § 7609(a)(4)(A). However, it is submitted that the IRS could not circumvent the procedures of Code § 7609(a), either, merely by advising a Code § 7609(a) record keeper that it was under audit.

The Eighth Circuit Court of Appeals, in *United States* v. *Barter Systems, Inc.*, 694 F.2d 163 (1982), applied a mechanistic interpretation to the statute. *Barter Systems, Inc.* involved an IRS audit of an organized barter exchange and a summons served on the exchange which predominantly sought information about the exchange's members. The Eighth Circuit ruled that the John Doe procedures did not apply because "the summons did identify the person with respect to whose liability the summons was issued, namely, [Barter Systems, Inc.], and therefore was not a John Doe summons." 694 F.2d at 168. That ruling, however, is too facile. It avoids the substantive and governing question: with respect to whose liability was the summons issued? The Eighth Circuit, when it responded to that question, merely looked to the face of the summons and answered with the words "Barter Systems, Inc." However, the face of the summons provided only a partial answer, and one capable of easy abuse. The summons in *Barter Systems, Inc.* sought books and records containing "[a]ll members' names and account numbers," information on "[e]xchange members transactions," and "[a]ll monthly account statements for each exchange member." 694 F.2d at 165. Under these circumstances, a simple statement that the summons was issued only with respect to Barter Systems, Inc.'s tax liability ignores both the purpose and the substance of the summons. The decision of the Eighth Circuit attempts to resolve any conflict between section 7609(f) and Code § 7602 by relying on the words that appear on the face of the summons. This kind of mechanistic approach to the conflict overlooks the importance of section 7609(f), an importance which is clearly described in the legislative history, discussed below.

C. The Legislative History Of Section 7609(f) Confirms The Literal Meaning Of The Statute And The Need To Accommodate The Investigatory Power Of The IRS With The Congress's Directive On John Doe Summonses.

1. *Restrictions on IRS investigations are rarely imposed.*

It is not often that the Congress imposes restrictions on the IRS's investigatory authority. Generally, the IRS is free to wield its investigatory powers without seeking permission from, or answering to, anyone. It can place any taxpayer whom it chooses under audit at any time that it chooses, and it can serve summonses wherever it deems it necessary. And even when the Service is called upon to justify its actions in court, the only limitations Congress has placed on it, besides the third party summons rules at issue in this case, are that the information sought by the IRS be "relevant or necessary" to an audit (Code § 7602(a)), that a taxpayer be audited only once unless a second audit is necessary (Code § 7605(b)), that a taxpayer be given at least 10 days to comply with a summons (Code § 7605(a)), and that no administrative summons be served on a taxpayer once the Justice Department has recommended a criminal investigation (Code § 7602(c)). Most of these restrictions on the Service have been in the tax statutes since 1939 or earlier. Apart from the restrictions relating to criminal investigations, the third party summons rules were the first restrictions placed on IRS investigations in more than 37 years. Congress did not intend that the John Doe summons rules be taken lightly or that they become inapplicable merely because a summons is served on a record keeper while under audit.

2. *The Congress' intent.*

The history of section 7609 begins with a decision of this Court. In *United States* v. *Bisceglia*, 420 U.S. 141, 95 S.Ct. 915, 43 L.Ed.2d 88 (1975), the Court held that, under the law at that time, the IRS had the authority to serve a John Doe summons, as long as it was not engaged in a fishing expedition. Section 7609(f) was enacted in response to this decision. See the *General Explanation of the Tax Reform Act of 1976*, Prepared by the Staff of the Joint Committee on Taxation, December 29, 1976 (hereinafter, "*General Explanation*"), at 364 (reproduced at 1976-3 (Vol. 2) Cum. Bull. 376), which refers specially to *Bisceglia* as the authority for the IRS power which section 7609(f) was designed to curb. Congress was clearly concerned about the use of that power. The *General Explanation* provides, at 364-365, 1976-3 (Vol. 2) Cum. Bull. 376-377 (emphasis supplied):

> The use of the administrative summons, including the third-party summons, is a necessary tool for the IRS in conducting many legitimate investigations concerning the proper determination of tax. The administration of the tax laws requires that the Service be entitled to obtain records, etc., without an advance showing of probable cause or other standards which usually are involved in the issuance of a search warrant. On the other hand, the use of this important investigative tool should not unreasonably infringe on the civil rights of taxpayers, including *the right to privacy*.
>
> Even prior to the enactment of this provision, the Service had instituted an administrative policy designed to establish certain safeguards in this area. Under this policy, IRS representatives were instructed to obtain information from taxpayers and third parties on a voluntary basis where possible. Where a third-party summons is [sic] served, advance supervisory approval was required. In the case of a John Doe summons, the advance supervisory approval was required to be obtained on a high level basis. The Congress decided, however, that

> these administrative changes, while commendable, do not fully provide all of the safeguards which might be desirable *in terms of protecting the right of privacy*.

And while seeking to preserve the use of the John Doe summons, Congress desired to assure that it was not used to conduct fishing expeditions:

> While the Congress believes it is important to preserve the John Doe summons as an investigative tool which may be used in appropriate circumstances, at the same time, the Congress does not intend that the John Doe summons is to be available for purposes of enabling the Service to engage in a possible "fishing expedition." For this reason, the Congress intends that when the Service does seek court authorization to service [sic] this type of summons, it will have specific facts concerning a specific situation to present to the court.

General Explanation, at 369-370, 1976-3 (Vol. 2) Cum. Bull. at 381-382.

In enacting section 7609(f), Congress demonstrated the utmost concern for the privacy rights of the citizenry. It referred to those rights repeatedly. *See also* H. Rept. 94-658, 94th Cong., 1st Sess., at 306-312, 1976-3 (Vol. 2) Cum. Bull. 998-1004. In deference to those rights, Congress imposed a narrow but important limitation on the Service's ability to cond ct investigations.

It was appropriate that Congress, in its wisdom, should be concerned about IRS invasions of privacy. Other laws enacted by Congress, and decisions of this Court interpreting those laws, have accorded the IRS greater and broader powers than any other institution in the United States to inquire in depth into the most intimate financial and personal details of every citizen. *See, e.g., United States* v. *Powell*, 379 U.S. 48, 57-58 (1964). No other

government agency has such power. Congress did not take that power away from the IRS when it enacted section 7609(f). Instead, it said that if the IRS wants to apply that power to people whose identities are not even known to it at the time, first it has to justify its actions in a court of law. It has to seek *ex parte* court approval prior to issuing a John Doe summons. Given the scope of the Service's authority and the ease of the *ex parte* procedure, this limitation is a small one indeed. But its importance is not to be overlooked. Congress did not expect that limitation to be circumvented by a procedure as simple as putting a record keeper under audit—*particular when the record keeper can be put under audit at any time by the very institution upon which Congress was imposing the limitation.*

The IRS as an institution even appears to expect that, when a tax shelter promoter is under audit, the agent will use a John Doe summons to obtain its client list. One of the responsibilities of the District Office under the Service's Tax Shelter Program is to

> assure that, before a John Doe summons is sought against a promoter, a project has been established with respect to the particular shelter promotion involved and the Service will be moving to investigate investors involved in the schemes.

IRM § 42(17)2.3(3) (*CCH* at 7347-32).

The legislative history of section 7609(f), and the Service's apparent understanding of it, thus confirm the plain meaning of the statute: when the IRS serves a summons seeking the identities of unknown taxpayers, section 7609(f) applies. It is the protection which Congress specifically and intentionally placed between the IRS and unknown targets of IRS summonses. Agent Lewis did not follow the procedures required by section 7609(f), and the

summonses he served should therefore be quashed or limited in scope.

D. Due process requires compliance with section 7609(f).

Requirements of due process also mandate that the Service follow the procedure set forth in section 7609(f) prior to issuing summonses such as those served on Tiffany. In *Hannah* v. *Larche*, 363 U.S. 420, 80 S.Ct. 1502, 4 L.Ed.2d 1307 (1960), this Court described the due process balancing test as follows:

> "Due process is an elusive concept. Its exact boundaries are indefinable, and its content varies according to specific contexts . . . Therefore as a generalization, it can be said that due process embodies the differing rules of fair play, which through the years have become associated with differing types of proceedings. Whether the Constitution requires that a particular right obtain in a specific context depends upon a complexity of factors. The nature of the alleged right involved, the nature of the proceeding and the possible burden on that proceeding, are all considerations which must be taken into account.

363 U.S. 441-442.

The principle of "rules of fair play" described in *Hannah* v. *Larche* requires the Service's compliance with section 7609(f) in this case. The "nature of the right involved" is the right of privacy of unknown taxpayers and their freedom from unwarranted intrusion by the IRS—a significant right which deserves this Court's recognition and which, in fact, the Congress has directed the courts to recognize. On the other hand, the nature of the proceeding provided by Congress for safe-guarding that right is not a difficult one—it is a simple *ex parte* proceeding in which determinations are made "solely on the petition

and supporting affidavits" of the government. Code § 7609(h)(2). Moreover, the government's burden in the proceeding is a light one. *See, e.g., In the Matters of Tax Liabilities of John Does*, 671 F.2d 977, 979 (6th Cir. 1982). In fact, the legislative history of section 7609(f) requires that this burden be light:

> [T]he Congress does not intend to impose an undue burden on the Service in connection with obtaining a court authorization to serve this type of summons. For example, the Service is not required to show that there is "probable cause". . . . It is enough for the Service to reveal to the court evidence that a transaction has occurred, or may have occurred, and that the transaction (in the context of such facts as may be known to the Service at that time) is of such a nature as to be reasonably suggestive of the possibility that the correct tax liability with respect to the transaction may not have been reported. . . .

General Explanation, at 370, 1976-3 (Vol. 2) Cum. Bull, at 382. It is hard to find a burden lighter than that. Finally, the ultimate consequences of a summons which seeks to identify unknown taxpayers should not be overlooked. It is almost certain that such a summons will result in an IRS investigation of the taxpayers, an investigation which could cost them dearly if the results are unfavorable and which, regardless of the outcome, will surely cost them time and money just to be unwilling participants. The "complexity of the factors" involved in such summonses requires the application of section 7609(f).

In the case before the Court, due process is provided only by the judicial review procedures set forth in section 7609(f). This due process protection cannot be evaded by the guileful drafting of a summons which simply names the putative record keeper as a target of the audit. Due

process requirements transcend the easy manipulation of the words on the face a summons to govern the substance of administrative or judicial process.

In this case, the targets of the IRS investigation are clearly unknown third-party taxpayers. The burden on the Service to comply with section 7609 is slight in contrast to the explicit intent of Congress to place such investigations under some judicial supervision. Under a due process balancing test, the scale tips clearly in favor of enforcing the procedure set forth in section 7609(f).

E. The Deferential Standard Accorded To The Service's Summons Authority Is Not Applicable With Respect To The Summonses In This Case Because It Is The Courts' Own Authority Which Is At Issue And Because The Circumstances Under Which Deference Is Accorded The IRS Are Not Present.

1. *The courts' authority.*

In *United States* v. *Gottlieb*, 712 F.2d 1363 (11th Cir. 1983), the Eleventh Circuit avoided a statutory analysis of section 7609(f). *Gottlieb*, like *Barter Systems, Inc.*, *supra*, involved a barter exchange which was under audit, and a general summons seeking the identities of exchange members. The Eleventh Circuit ordered the enforcement of the summons under the rationale that "a deferential standard must be applied when construing congressional intent regarding the scope of the IRS's summons authority." 712 F.2d at 1368. In the case before the Court, the Second Circuit used the same rationale. 718 F.2d at 13. On many occasions, this Court has applied a deferential standard when construing Congressional intent regarding the scope of the Service's summons authority. This rule is described in *United States* v. *Euge*,

444 U.S. 707, 100 S.Ct. 874, 63 L.Ed.2d 141 (1980), as follows:

> [I]f the summons authority claimed is necessry for the effective performance of Congressionally imposed responsibilities to enforce the tax Code, that authority should be upheld absent express statutory prohibition or substantial countervailing policies.

444 U.S. at 711.

The application of the deferential standard described in *Euge* is wholly inappropriate in this case. In *Euge*, only Code § 7602 was being interpreted. The Court was determining whether, under Code § 7602, the Service had the investigatory authority that it claimed to have. That issue was resolved, altogether appropriately, under the deferential standard rule.

In the case before the Court, the issue is whether the John Doe summons procedures of section 7609(f) apply—and the most important aspect of the section 7609(f) procedures is the requirement that a court approve the summons before it is served. A resolution, therefore, of whether section 7609(f) applies is also a resolution of the scope of the courts' authority to review IRS summonses before they are issued. It is not just the Service's authority that is at issue in this case. It is the courts' authority, as well. If this Court holds that section 7609(f) does not apply to summonses such as those served on Tiffany, it will also hold that the federal courts have no pre-issuance authority over such summonses. The Court may prove inclined to so decide, but to make that decision based on the deferential standard is to say, not just that the Service's authority must be liberally construed, but that the courts' authority must be narrowly construed because the Service's powers are so great. That is an extension of the deferential standard far beyond what this Court intended

in *Euge*. Indeed, since section 7609(f) empowers federal courts to review the propriety of John Doe summonses, it is tantamount to a jurisdictional statute and should be "construed both with precision and fidelity to the terms by which Congress has expressed its wishes." *Chang Fan Kwok* v. *Immigration Service*, 392 U.S. 206, 88 S.Ct. 1970, 20 L.Ed.2d 1037 (1968). *See also, Palmore* v. *U.S.*, 411 U.S. 389, 93 S.Ct. 1670, 36 L.Ed.2d. 342 (1973).

2. *The Circumstances Under Which The Deferential Standard Is Applied.*

Even if the courts' authority were not at issue in this case, it would be inappropriate to apply a deferential standard in interpreting section 7609(f). The Court's description in *Euge* of when that deferential standard is used shows why the rule is inappropriate here.

The issue in *Euge* was whether, under its summons authority, the IRS could require a taxpayer to furnish hand-writing exemplars so that the Service could determine whether the taxpayer maintained several bank accounts under other names. In *Euge*, the IRS agent found several bank accounts which he suspected belonged to the taxpayer because the account statements were sent to post office boxes held in his name and because the signature cards for the accounts listed addresses of properties which he owned. The only statute being interpreted in *Euge* was Code § 7602, and the Court, in upholding the Service's authority, stated (444 U.S. at 711):

> The authority claimed here is necessary for the effective exercise of the Service's enforcement responsibilities; it is entirely consistent with the statutory language; and it is not in derogation of any constitutional rights or countervailing policies enunciated by Congress.

The facts and law surrounding the *Euge* decision are a far cry from the case presently before the Court. The summons authority claimed by the IRS in this case, while it may assist the IRS in the performance of one Congressionally imposed responsibility, runs exactly counter to another Congressionally imposed responsibility—to use the John Doe summons procedures when the summons seeks the identities of unknown taxpayers. Moreover, in *Euge*, there was no express statutory prohibition on the IRS's exercise of the authority it claimed. In the case before the Court, section 7609(f) does contain an express limitation. Also, in *Euge* there was no substantial countervailing policy that weighed against the Service's claimed authority. But here there is a policy—a policy created by the Congress itself in recognition of taxpayers' rights of privacy. Finally, in *Euge*, the agent knew exactly what he needed in order to perform his responsibilities. For him, the handwriting samples were the next logical step in his investigation and, no doubt, a necessary step. In the present case, Agent Lewis has yet to see one page of Tiffany's books and records and cannot possibly know what information he needs to audit Tiffany. If his enforcement responsibilities presently include only the audit of Tiffany, it is uncertain whether the authority he claims is at all necessary for the effective exercise of those responsibilities.

The deferential standard accorded the IRS's investigatory powers was also described in *United States* v. *Bisceglia, supra*. In *Bisceglia*, decided before the enactment of section 7609(f), the issue was whether the IRS had the authority to issue a John Doe summons. The Court ruled that, subject to the *Powell* standards *(United States* v. *Powell, supra)*, it did: "Settled principles of statutory interpretation require that we avoid [a result which frustrates broad IRS inquiries] absent unambi-

guous directions from Congress." 420 U.S. at 150. Of course, Congress provided those directions when it enacted section 7609(f). It said, in effect, that the IRS cannot issue John Doe summonses without first complying with the requirements of section 7609(f)—plain, unambiguous directions.

Are these directions to be so easily circumvented through the use of a summons served on a record keeper who was just placed under audit? That is the issue before the Court. But it is not to be resolved under a deferential standard test. The "deferential standard" has been developed in cases entirely different from the case before the Court and, indeed, the language in which that test is expressed does not cover this case at all. The authority claimed by the IRS in this case is inconsistent with the statutory language of section 7609(f), may not be necessary to the IRS to exercise its responsibilities, and is in substantial derogation of a countervailing policy clearly enunciated by Congress. This Court, it is hoped, is to decide what section 7609(f) means, but not by examining it in a light which accords deference to the IRS.

F. Analogies To Summonses Issued During Civil/Criminal Investigations Are Inappropriate.

In upholding enforcement of the summonses in the present case, the Second Circuit Court of Appeals compared the summonses to those served in the course of an IRS investigation which is both civil and criminal in nature, and noted that such summonses were enforced as long as the Service had not abandoned the civil aspects of the case. 718 F.2d 13. It cited two decisions of this Court: *United States* v. *LaSalle National Bank*, 437 U.S. 298, 98 S.Ct. 2357, 57 L.Ed.2d 221 (1978), and *Donaldson* v. *United States*, 400 U.S. 517, 91 S.Ct. 534, 27 L.Ed.2d 580

(1971).[3] However, this analogy to civil/criminal investigations is inappropriate to the kind of investigation being conducted in this case and it results in an undermining of section 7609(f) which is unnecessary.

The rationale of *LaSalle National Bank* and *Donaldson* is a sensible one. If a summons could be quashed merely because the Service was interested in discovering possible criminal conduct by the taxpayer, no meaningful investigation of the taxpayer's civil liability could proceed. *See United States* v. *Powell*, *supra*, 420 U.S. at 150. The Service would have no alternative means of obtaining information relevant to the civil tax investigation. The investigation of the taxpayer would effectively be over. Moreover, the taxpayer suspected of criminal conduct would obtain greater protection from investigation than would a taxpayer who was not suspected of committing any criminal acts.

No such anomalies arise if the Service is required to comply with section 7609(f) when the summons is designed to identify unknown taxpayers. The consequence of quashing a summons for failing to comply with section 7609(f) is much less significant than the consequence of quashing a summons in an investigation that is partially criminal in nature. If a summons is quashed because the Service has failed to comply with section 7609(f), the Service has at least two options available to it. It may either proceed to satisfy the requirements of section 7609(f), or it may narrow the scope of its summons to

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[3] The holding in these cases has been superseded by the enactment of Code § 7602(c), which prohibits the issuance of a summons after a criminal recommendation has been made by the Department of Justice.

demand under section 7602 that portion of the information which does not identify unnamed taxpayers. Such a compromise is exactly what Tiffany offered in this case. JA 18a. Either way, the investigation continues.

Section 7609(f) is clearly intended to impose some limitation on the unfettered authority of the Service to investigate unnamed taxpayers. The recognition of this limitation does not limit the authority of the Service to investigate the taxpayer served with the summons, as the Court feared in the line of civil/criminal summons cases. Quashing the summonses in this case will not prevent the Service from conducting a complete audit of Tiffany or any other named taxpayer. (As a practical matter, the Service rarely requires the identities of clients in order to audit a taxpayer, anyway (except, perhaps, in an all-cash business).) If the Service chooses not to comply with the provisions of section 7609, it may nevertheless proceed with its audit of Tiffany with all the other available information. If, during the audit, the Service concludes that it cannot complete the audit without the names of Tiffany's clients, the Service may, at that point, seek an order to produce such records in accordance with section 7609(f).[4] As discussed below, the Service might have even obtained these records under Code § 7602 had it followed its own audit procedures.

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[4] It is not uncommon to require the Service to establish that it cannot complete the audit without the appropriate third party information prior to permitting it to obtain additional information. The Court of Appeals for the First Circuit has adopted such a two step process for taxpayer discovery purposes. *United States* v. *Salter*, 432 F.2d 697 (1st Cir. 1970).

G. The Applicability Of Section 7609(f) Does Not Restrict The Service's Ability To Audit The Record Keeper As Long As It Conducts Its Audits Properly.

The legislative history of section 7609(f) shows that the Sixth Circuit's common-sense interpretation in *United States* v. *Thompson* of the plain meaning of the statute is the better interpretation. The question—what was the purpose of the summons—must be confronted in a fashion which gives meaning to the intent of Congress and the language of the statute. And if a purpose of the summons was to obtain identities of unknown taxpayers, then Congress's concern in enacting section 7609(f) cannot be ignored. Section 7609(f) must apply.

In *United States* v. *Gottlieb*, *supra*, the Eleventh Circuit supported its decision to the contrary by reasoning that, if the IRS could not have the members' identities under a John Doe summons, then it would be unable to obtain such information at all—a result which impeded in an unacceptable manner its authority to investigate the barter exchange. The Court stated:

> "In other words, the IRS must have an independent right to obtain third-party recordkeeper's records for purposes of auditing the recordkeeper. Under such circumstances, where the IRS could obtain the records in any event without regard to whether the § 7609(f) requirements were met, it would be meaningless to impose the § 7609 requirements in the first instance."

712 F.2d at 1369.

Following this rationale, one might also ask, Why have section 7609(f) at all? If the Service can always get clients' identities by placing the record keeper under audit, section 7609(f) becomes hollow law—words without substance—which might as well be judicially excised

from the statute. Such judicial excision, however, is hardly possible in light of the language of the statute and the importance ascribed to it by the legislative history. In any event, the dilemma described by the Eleventh Circuit is not a dilemma at all—other than one of the Service's own making.

The Service did not have to find itself in the predicament the court in *Gottlieb* fears. Had it commenced an orderly audit of Tiffany, examined the company's journal, ledger and other records, and then concluded that it was necessary to contact Tiffany's clients in order to complete the audit of Tiffany, this case would not be under consideration today. That, after all, is how the IRS, according to its own manual, is supposed to conduct audits.

Auditing procedures and techniques for agents are contained in the Manual publication "Tax Audit Guidelines for Partnerships, Estates and Trusts, and Corporations," Manual Transmittal 4233 (*CCH* at 7281) (hereinafter referred to as "the Guidelines"). Chapter 200 of the Guidelines contains "Audit Techniques for Business Returns." It states (Section 210, *CCH* at 7281-11):

> The examination at the taxpayer's office may begin with miscellaneous records other than the actual ledgers and journals. Frequently, these records indicate items which the examiner should be alert for as the examination progresses.

The "miscellaneous records" the Guidelines refer to include the corporate minute book, any audit reports of independent auditors, the stock transfer book, financial statements for credit purposes, and appraisals.

The Guidelines then suggest that the agent proceed to:

(i) examine the general ledger (Section 220, *CCH* at 7281-12);

(ii) reconcile the differences between the net income on the books and the net income on the tax returns (Section 221.1, *CCH* at 7281-13);

(iii) review cash disbursements (Section 231.2, *CCH* at 7281-15); and

(iv) examine notes and accounts receivable (Section 231.3, *CCH* at 7281-15 - 7281-16).

The Service itself clearly expects its agents to get an overview of the company under audit before seeking specific documents other than the standard books of accounts. Had Agent Lewis followed his own manual, this matter would not be before the Court. Tiffany would be hard-pressed to demonstrate that the IRS served the summonses in order to circumvent section 7609(f). Tiffany might have attempted to show that it was not necessary for the IRS to have its entire client list, or at least some portion of it, and the summonses might have been limited based on that ground, *see United States* v. *Bisceglia*, *supra*, but Tiffany would not have been able to make a credible argument that the Service was trying to circumvent section 7609(f). It is the manner in which the Service has proceeded that raises doubts about its true purpose—and rightfully so.

The Eleventh Circuit's rationale in *Gottlieb* presumes that the Service's purpose in serving the Code § 7602 summons was a legitimate one. But if the Service's purpose in serving the summonses on Tiffany was to obtain the identities of its clients, then it should have proceeded under section 7609(f), and its Code § 7602 summons was *not* served pursuant to a legitimate purpose. *Powell*, *supra*. When, as in the case before the Court, the Service had adopted an institutional posture to audit people such as Tiffany's clients and when, as here, the Service, con-

trary to its own audit procedures, starts the audit of the record keeper by asking for a list of those clients, the Service on its own raises doubts as to the legitimacy of its purpose. At that point, the only way to preserve the integrity of section 7609(f) is to deny the Service the information protected by section 7609(f) unless it meets the John Doe requirements. If the Service cannot meet its section 7609(f) burden, then a question truly arises as to whether the record keeper was in fact put under audit in the first place so that section 7609(f) could be avoided. If that is the case, then the purpose of section 7609(f) is certainly defeated, unless the decision in *United States* v. *Thompson* is followed.[5]

H. The Potential For Abuse Of The Courts' Process Requires The Application Of Section 7609(f) To Summonses Such As Those Served On Tiffany Or, At The Least, An Examination Of Whether Section 7609(f) Should Apply In Certain Cases.

If section 7609(f) does not apply to summonses such as those served on tiffany, there is enormous potential for abuse of the courts' process in the enforcement of general summonses.

The legislative history of section 7609(f) makes one thing indisputably clear: Congress enacted section 7609(f) to curb the potential misuse of the John Doe summons process after this Court's decision in *United States* v. *Bisceglia*. Congress enacted section 7609(f) so that a

[5] One reason the Service might prefer the Code § 7602 summons is that the section 7609(f) procedures take more time and, while the Agent is awaiting internal IRS approval of the summons, statutes of limitations for the tax returns of the taxpayers sought to be identified may expire. This problem is also one of the Service's own making.

court would supervise the Service's use of such summonses. The *General Explanation* states, at 365, 1976-3 (Vol. 2) Cum. Bull. 377:

> In the case of a John Doe summons, advance notice to the taxpayer [such as that required by section 7609(a) where the identity of the taxpayer is known] is obviously not possible. Here the Congress decided that the IRS agent should be required to show adequate grounds for serving the summons in an independent review process before a court before any such summons can be served.

Congress expected the courts to assure that John Doe summonses were not used to conduct fishing expeditions:

> . . .[T]he Congress intends that when the Service does seek court authorization to serve this type of summons, it will have specific facts concerning a specific situation to present to the court.

General Explanation, at 370, 1976-3 (Vol. 2) Cum. Bull. at 382.

Congress envisioned a limited but important role for the courts:

> The Congress contemplates that the court will review each John Doe summons to be sure that the material requested is reasonably related to the investigation, and that the summons is not overly broad in terms of the records requested.

Id.

As a practical matter, any time that the IRS wants to obtain client lists, under *Barter Systems, Inc.*, *Gottlieb*, and the Second Circuit's decision in this case, it can avoid the requirements of section 7609(f) merely by initiating an audit of a record keeper such as Tiffany, however specious or superficial the audit may be. If it serves a general summons requesting client lists and the record

keeper refuses to comply, the IRS asks the court to enforce the summons under Code § 7604. It enlists the aid of the court's process. If the only true reason for initiating the audit was to avoid the section 7609(f) requirements, the IRS abuses the court's process when it asks it to enforce a summons which is designed to circumvent the section 7609(f) rules.

In cases upholding the IRS's investigatory powers, this Court has always tempered its decisions with language designed to assure that the courts not permit their process to be abused. In *United States* v. *Powell*, *supra*, the Court allowed the enforcement of a summons to obtain books and records for periods barred by the statute of limitations and it set down the *Powell* standards for IRS investigations. The Court also stated:

> Nor does our reading of the statutes mean that under no circumstances may the court inquire into the underlying reasons for the examination. *It is the court's process which is invoked to enforce the administrative summons and a court may not permit its process to be abused.* Such an abuse would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute, or for any other purpose reflecting on the good faith of the particular investigation.

379 U.S. at 58 (emphasis supplied).

And in *United States* v. *Bisceglia*, *supra*, upholding the Service's authority to serve a John Doe Summons, the Court stated:

> We do not mean to suggest by this holding that respondent's fears that the § 7602 summons power could be used to conduct "fishing expeditions" into

the private affairs of bank depositors are trivial. However, as we have observed in a similar context:

> " 'That the power may be abused, is no ground for denying its existence. It is a limited power, and should be kept within its proper bounds; and, when these are exceeded, a jurisdictional question is presented which is cognizable in the courts.' " *McGrain* v. *Daugherty*, 273 U.S. 135, 166 (1927), quoting *People ex rel. McDonald* v. *Keeler*, 99 N.Y. 463, 482 (1885).

So here, Congress had provided protection from arbitrary or capricious action by placing the federal courts between the government and the person summoned. The District Court in this case conscientiously discharged its duty to see that a legitimate investigation was being conducted and that the summons was no broader than necessary to achieve its purpose.

420 U.S. at 150-151.

Section 7609(f) is the law, and it requires the courts to review John Doe summonses before they are served. The Service abuses the courts' process whenever it tries to avoid section 7609(f) with a general summons. The case before the Court strongly suggests that an attempt was made by the Service to circumvent the procedures of section 7609(f) by simply identifying the record keeper as an audit target. Tiffany alleges, without contradiction, that Agent Lewis initially asked for Tiffany's client list without even advising Tiffany that it was under audit. And even if Agent Lewis did advise Tiffany that it was under audit, he requested Tiffany's client list at the very beginning of an audit—before he had requested or looked at any of Tiffany's books and records. In fact, at the time, Agent Lewis knew so little about the company that he incorrectly thought that it sold lithographs. One has to wonder how Agent Lewis knew he would need Tiffany's

client list in order to audit Tiffany before he knew anything else about Tiffany except that it licensed Pedi-Pulsors.

If section 7609(f) does not under any circumstances apply to summonses such as these, the opportunity for abuse is apparent and real. At the least, the courts should inquire into the true purpose of the summons—if only to prevent themselves from being an instrument of an effort to circumvent section 7609(f). *Powell* would appear to mandate such an inquiry. The first rule of *Powell* is that an IRS investigation be conducted pursuant to a legitimate purpose. The purpose of obtaining identities of unknown taxpayers is not a legitimate purpose of a Code § 7602 summons. If the summons was served for that purpose, it cannot be enforced. The only way for the court to determine the purpose of the summons is to inquire into whether, in substance, it is a John Doe summons covered by section 7609(f).

CONCLUSION

For the reasons stated above, the decision of the Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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